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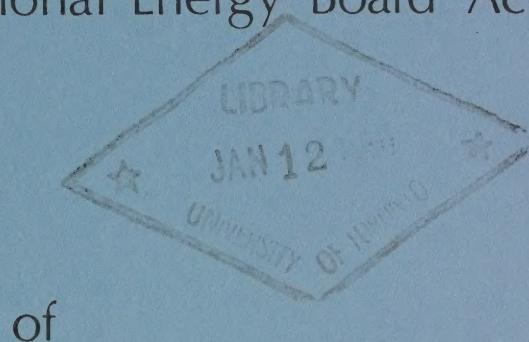
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NATIONAL ENERGY BOARD
REASONS FOR DECISION

In the Matter of the Application under
Part IV of the National Energy Board Act



of

Westcoast Transmission Company Limited

November 1980

NATIONAL ENERGY BOARD

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WESTCOAST TRANSMISSION COMPANY LIMITED

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Ce rapport est publié séparément dans les deux langues officielles

(i)

NATIONAL ENERGY BOARD

IN THE MATTER OF the National Energy Board Act and the Regulations made thereunder; and

IN THE MATTER OF applications by Westcoast Transmission Company Limited for certain orders respecting rates and tolls pursuant to Part IV of the National Energy Board Act, filed with the Board under File Nos. 1562-W5-3 and 1562-W5-4.

Heard in Vancouver, British Columbia on 6, 7, 8, 9, 11, 12, 13, 14, 15, 16, 18, 19, and 20 August 1980; and in Ottawa, Ontario on 3, 4, 5, 8, 9, 10, 11, and 12 September 1980.

BEFORE:

L.M. Thur	Presiding Member
J.R. Hardie	Member
R.B. Horner	Member

APPEARANCES:

R.J. Gibbs, Q.C.	)	Westcoast Transmission Company
J.W. Lutes	)	Limited
J.M. Pelrine	)	British Columbia Petroleum
D.G. Sanderson	)	Corporation
Beverly Silver-Corber)	
W. Mitchell	)	British Columbia Hydro and
D. Duff	)	Power Authority
C.B. Johnson	)	Inland Natural Gas Company
	)	Limited
J.B. Ballem, Q.C.	)	Canadian Petroleum Association
L.H. Pilon	)	TransCanada PipeLines Limited
R.B. Wallace	)	Council of Forest Industries of
J. Haythorne	)	British Columbia
W. Fruehauf	)	Cominco Ltd.
F.H.T. Dewdney	)	Consumers Glass Company Limited
	)	Domglas Inc.
	)	Hiram Walker & Sons Ltd.

E.R.A. Edwards) Attorney General of British
M.M. Moseley) Columbia

P.G. Griffin) National Energy Board

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ABBREVIATIONS

"AFC"	- Allowance for Funds Capitalized
"AFUDC"	- Allowance for Funds used During Construction
"AGBC"	- Attorney General of British Columbia
"B.C. Hydro"	- British Columbia Hydro and Power Corporation
"BCPC"	- British Columbia Petroleum Corporation
the "Board"	- The National Energy Board
"CBS"	- Canadian Business Service
"COFI"	- Council of Forest Industries of British Columbia
"COV"	- Coefficient of Variation
"CPA"	- Canadian Petroleum Association
"Foothills (Yukon)"	- Foothills Pipe Lines (Yukon) Ltd.
"DCF"	- Discounted Cash Flow
"Inland"	- Inland Natural Gas Company Limited
"Nova"	- Nova, An Alberta Corporation
"S & P"	- Standard and Poor's
"TransCanada"	- TransCanada PipeLines Limited
"Westcoast", the "Company", the "Applicant"	- Westcoast Transmission Company Limited

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CHAPTER 1
THE APPLICATION

Westcoast Transmission Company Limited ("Westcoast" or "the Company") is a "company" within the meaning of section 2 of the National Energy Board Act ("NEB Act") and operates a "pipeline" within the meaning of that section. The Company's corporate status and its pipeline system are fully described in the Board's Reasons for Decision of September, 1979, resulting from the first application by Westcoast respecting its tolls under Part IV of the NEB Act.

Since 1 November 1979, Westcoast has been charging for the transmission of natural gas through its pipeline the tolls prescribed by the Board in Order No. TG-5-79 dated 20 September 1979. The tolls prescribed are of the variable cost of service type and are calculated in respect of each month on the basis of the requirements set out in the Order.

By an application dated 31 March 1980, Westcoast applied to the Board for an order pursuant to sections 50, 52, and 53 of the NEB Act effective 1 April 1980, disallowing the existing tolls to be charged and received by the Company in accordance with Order No. TG-5-79 and prescribing a new schedule of tolls providing for certain changes in the manner in which the Company calculates its tolls. The changes applied for by Westcoast, as set out in paragraph 10 of the application, are as follows:

1. in calculating the rate base, to include amounts for employee expense advances, imprest petty cash funds, special deposits, employee housing loans, deferred relocation expenses and items related to premature reduction of rate base and to exclude an amount relating to employee payroll withholdings;
2. in calculating rate base, to include an allowance for Cash Working Capital amounting to 45 days of operating and maintenance expenses;

3. in calculating the cost of service, to include an amount for Corporation Capital Tax paid to the Province of British Columbia attributable to the Company's utility operations;
4. in calculating the cost of service, to utilize a Rate of Return Before Taxes on Rate Base of 19.49 percent;
5. in calculating the estimated effective income tax rate, to exclude any items of revenue and expense attributable to Westcoast's non-utility operations;
6. in calculating Deferred Income Taxes to be deducted from the rate base, to deduct from utility normalized income taxes those income taxes payable on its utility operations;

By an application dated 8 July 1980, Westcoast applied to the Board for approval to amend its application of 31 March 1980 so as to apply for a Rate of Return Before Taxes on Rate Base of 19.33 percent in place of that requested in the 31 March 1980 application. Because of the changes in circumstances arising since the filing of the original application, the Board approved the amendment requested by Westcoast on 16 July 1980.

Except for the matters specified in paragraph 10 of its application as amended, Westcoast did not propose any other changes in the manner in which its tolls were to be determined pursuant to Order No. TG-5-79.

In paragraph 11 of its application, the Company also applied under sections 50, 52, and 53 of the NEB Act for an order fixing interim tolls which it might charge for and in respect of gas transported or sold by it from and after 1 April 1980. The proposed interim tolls were to be calculated in accordance with Order No. TG-5-79, except that the Rate of Return before Taxes on Rate Base was to be the 19.49 percent applied for in paragraph 10 of the original application in lieu of that specified in the Order. In its application, Westcoast indicated that it would be a condition of any order permitting

the proposed interim tolls that the Company would refund any portion of those interim tolls collected which exceeded the tolls the Board found to be just and reasonable as a result of its decision on paragraph 10 of the application. The Board dismissed the request for an order permitting interim tolls for the reasons set out in the Board's Reasons for Decision of August, 1980.

By Order No. RH-4-80 dated 5 June 1980, the Board set down for public hearing that part of Westcoast's application under Part IV of the NEB Act for the changes in the manner of calculating its tolls specified in paragraph 10 of its application of 31 March 1980, as amended, together with the submission of 28 March 1980 by the Company respecting its Operating and Maintenance Expense budget for the six-month period ending 31 December 1980. On 16 September 1980, the Board issued Order No. AO-2-TG-5-80 fixing the Operating and Maintenance Expense budgets for that period.

By a letter dated 8 April 1980, B.C. Hydro requested the Board to direct Westcoast to provide B.C. Hydro with information relating to rate base additions since 31 December 1978. It was indicated by B.C. Hydro that it required the information in order to avail itself of the right to make applications or complaints to the Board with respect to the tolls to be charged by Westcoast. The Board directed Westcoast to respond to that request. Because Westcoast's application of 31 March 1980 contained a forecast of the Company's rate base to 31 December 1980, the Board advised B.C. Hydro that any complaints it had respecting Westcoast's rate base could be dealt with in the hearing of Westcoast's application of 31 March 1980.

CHAPTER 2RATE BASE2.1 Gas Plant in Service2.1.1 Plant Retirement - W-92 Turbine Units

At the time of the hearing, Westcoast had a total of 16 Westinghouse W-92 gas turbine units in operation along its pipeline system, and had experienced numerous operating problems with them. The Company proposes to eventually replace all its W-92 units. As a first step, Westcoast made an application to the Board dated 9 October 1979 for the replacement of two W-92 units at the Compressor Stations 4A and 6A. The application was approved by Board Order XGM-17-79, dated 29 November 1979 and the completion of the replacement was scheduled for 1 November 1980.

The Company proposed to retire those units under the ordinary retirement provisions of the Board's Gas Pipeline Uniform Accounting Regulations.

During the Hearing, intervenors suggested that, rather than considering their retirement as an extraordinary retirement, the 16 W-92 units be treated as a separate group for depreciation purposes and that they be assigned a higher rate of depreciation.

The Company indicated that the original cost of the two units was \$2.8 million in 1964, and the projected net book value at the time of replacement would be approximately \$1.3 million. Westcoast stated that it intended to salvage the useful spare parts from the W-92 units it was scrapping under Board XGM-17-79 for use in maintaining the remaining W-92 units, and to record them into the "Materials and Supplies" account. An amount of \$1.47 million was estimated by the Applicant as the salvage value, based on the current costs for obtaining similar new parts.

The Board's Gas Pipeline Uniform Accounting Regulations require that the value of the salvaged parts should represent a fair estimate of the original cost of the parts. Consequently, Westcoast is requested to submit to the Board, on or before 2 February 1981, its best estimate of the original cost of the parts salvaged from these compressors. The value of these parts is to be credited as salvage in determining the amount of the net book value of the retired turbines to be amortized to cost of service.

After consideration of the various alternatives available, the Board has decided that any W-92 units replaced be treated as extraordinary retirements, because these are major items of plant which have been prematurely retired due to operating problems. Effective 1 March 1981 the retirement of those two W-92 units will be recorded in Account 171 as extraordinary retirements and the balance in that account (equal to the net book value after credit of salvage) will be amortized to cost of service over a period of twelve months commencing 1 March 1981.

2.1.2 Pine River Gas Processing Plant

Westcoast made an application to the Board dated June 1977 for a certificate to construct the Pine River Gas Processing Plant. In January 1978 the Board granted Westcoast a certificate to construct the facilities. Condition 9 of the certificate, which relates to the design of sulphur storage and water treatment facilities, was satisfied in May, 1978, and construction commenced immediately thereafter. A leave-to-open order was granted in November of 1979.

The original cost estimate of the Pine River processing facilities, i.e., \$75,000,000, was prepared by Westcoast and by an independent engineering firm specializing in the design of gas plants.

Westcoast stated that there had been no facility constructed in Western Canada similar in size and scope to the Pine River Gas Processing Plant. Westcoast also stated that the factored cost estimate was based on the historical costs of constructing other gas processing plants, but without the benefit of definitive engineering design. Since no two plants are exactly alike, it applied a judgement factor to estimate cost differences due to:

- a) the size of the plant,
- b) the chemical composition of the raw gas to be processed
- c) the location of the plant, and
- d) the timing of construction.

The projected final cost of the plant is now estimated to be \$105,968,447.

In response to an information request from the Board for an explanation of the variance between the estimated cost of the plant and the actual cost, Westcoast indicated that an increase of \$23 million was due to relocating the site from Hasler Flats to High Hasler and the final engineering design, and that a further increase of \$7 million was caused by:

- a) a delay in the start of the project,
- b) a change in the processing method,
- c) an increase in labour requirements, and
- d) an increase in labour rates.

The Board recognizes that the relocation of the plant site and the detailed engineering design, among other factors, have contributed to the increased cost of the project.

However, the Board requires that Westcoast provide to the Board and interested parties, on or before 2 February 1981, copies of the studies which established the original estimates and a detailed explanation of the variances between the original estimate and the final costs. Westcoast should also advise at what point in the construction it was apparent that the various increases were being incurred.

2.1.3 Pine River Start-up Gas

The CPA raised the possibility that the "Pine River Start-up Gas" might have been supplied directly from the gas producers at an average price of \$1.27 per Mcf (\$44.93 per 10^3 m^3). However, Westcoast established that the start-up gas was purchased from the BCPC at a cost of \$2.64 per Mcf (\$93.40 per 10^3 m^3). The Board agrees that the cost of this gas should be recorded at the price at which it was purchased by Westcoast, i.e., \$2.64 per Mcf (\$93.40 per 10^3 m^3).

2.2 Working Capital

2.2.1 Security Pipe

The CPA recommended that the security pipe be amortized to the cost of service because the pipe no longer meets the current specification as set out in Revision No. 44 of Westcoast's No. 102 "Specification For High Strength Steel Pipe".

In cross-examination, Westcoast explained that the revised specification for high strength steel pipe applied to new pipelines. The Company's policy is to repair or replace existing pipelines with materials from inventory, unless there is some special reason for using higher quality pipe. It was also stated by the Company that the existing inventory of security pipe is in good condition and available to be used for repair purposes.

The Board allows the security pipe to be used for repair purposes in those instances where it conforms with the specifications of the pipe to be replaced. Therefore, the repair pipe should be retained in Materials and Supplies until used and not be amortized.

2.2.2 Prepaid Expenses

Vancouver Island Project

Westcoast included \$25,000 in its rate base for Vancouver Island Project expenses. The Vancouver Island Project is a proposal by Westcoast to construct a branch line extending from its main transmission line at Williams Lake to Powell River, together with a marine crossing to Comox on Vancouver Island. Under cross-examination, a witness for the Company stated that this amount represented preliminary studies with respect to this proposed project, which Westcoast considers to be an extension of its present utility system.

Some intervenors questioned this item and stated that it was speculative for Westcoast to include these costs in rate base at this time.

The Board accepts the inclusion of these preliminary costs in rate base, since they relate to a proposed expansion of the Company's pipeline system. However, Westcoast is required to include expenditures for studies related to this project in "Preliminary Surveys and Investigations", and should specifically identify this item in the monthly cost-of-service information filed pursuant to Order TG-5-79.

2.2.3 Cash Working Capital

Westcoast applied to include an allowance for Cash Working Capital in rate base amounting to 1.5 times the monthly Operating and Maintenance expenses, excluding charges for transportation by others. The working capital allowance factor of 1.5 used by the Company is the product determined by dividing the lag days resulting from the Company's lead/lag study (45) by the average number of days in a month (30). The 45-day lag is made up of an average lag on operating expenses of 39 days and a six-day cash expense cushion.

39-Day Lag on Operating Expenses

The average lag on operating expenses of 39 days identified by the Applicant resulted from the combination of expense payment lead/lag and the revenue receipt lead/lag.

The BCPC submitted that the 39 days identified by Westcoast should be reduced by six days. It contended that since Westcoast receives revenues from Inland and B.C. Hydro on the twentieth of the month, but, on average, is not required to pay for gas until the twenty-fourth of the month, the lag should be reduced by four days. The BCPC stated that, on average, more than enough revenue is collected on the twentieth of the month to meet operating and maintenance expenses. It also proposed that the lag should be further reduced by one day since Westcoast, in respect of payment of expenses, did not give consideration to the time required for a cheque to clear the bank, but rather used the date of the cheque as the date the expense was incurred. In addition, it proposed that the lag should be reduced by one day because Westcoast included as a lag day the date on which Westcoast received revenue payments.

It is the opinion of the Board that a reduction of the lag to reflect the collection of revenue from Inland and B.C. Hydro on the twentieth of the month following the cost-of-service period is not warranted. The Board recognizes that the Company's lead/lag study identified the average gas purchase payment date to be the twenty-fourth of the month following the cost-of-service period. However, the average revenue receipt date identified in the lead/lag study is also the twenty-fourth of the month following the cost-of-service period. In the Board's view, the fact that Inland and B.C. Hydro make payments to Westcoast on the twentieth day has already been taken into account in establishing the average.

It is also the Board's view, in this case, that the total lag should not be reduced to reflect the time required for a cheque to clear the bank.

Furthermore, the Board does not consider appropriate a reduction in the 39-day lag for the day on which revenue payments are received because the funds may not be available to

the Company for the entire day in respect of every revenue payment.

The Board finds that the 39-day lag for operating expenses is appropriate.

Six-Day Cash Expense Cushion

It was the Company's position that in deriving the 39-day average there is an assumption that Westcoast can instantly react to all variations from the average and that the financial community will allow it to borrow or invest any amounts for short periods of time on a moment's notice. The Company submits this is not the case, and thus a six-day cushion above the 39-day level is required to give recognition to variations in its cash needs.

The BCPC and the COFI disagreed with the six-day cushion on the grounds that in using an average of 39 days there is already an assumption that in some months the working capital allowance requirement will be less than 39 days and in other months will be more. Both were of the opinion that Westcoast could borrow or invest money on short notice.

It is the opinion of the Board that, should variations exist, they exist on both sides of the average of 39 days due to the very nature of the 39-day average. In addition, the Board is of the opinion that Westcoast is able to immediately react to variations.

The Board finds that the provision of a six-day cash expense cushion is not justified.

Offsets

The BCPC contended that Westcoast should not be allowed a cash working capital allowance since the cash required to meet expenses would be offset by the early collection of revenue from Inland and B.C. Hydro and the fact that payment to out-of-province producers is not required until one day after the average revenue receipt date, as well as the fact that revenue is collected in advance of the dates on which bond interest and preferred dividends are payable.

The Board notes with regard to the matter of payment dates for gas purchased that the lead/lag study indicates that the average revenue receipt date and the average gas purchase payment date are both the twenty-fourth of the month following the cost-of-service period. The Board considers that the fact that some receipts are earlier and some gas purchase payments are later is irrelevant, and that these offsets to cash working capital are not appropriate.

The BCPC argued that Westcoast collects as part of its return each month amounts in respect of bond interest and preferred dividends, while payments of preferred dividends and bond interest for each series except some of the first mortgage bonds are required only every six months.

The Board does not view the timing difference between the monthly collection of the return component of cost of service and the payment of bond interest expense and preferred dividends to be an issue relating to the determination of a working capital allowance, given the existing system used in determining the Company's overall rate of return. Under the existing system, bond interest expense and preferred dividends are part of rate of return. Thus the timing of either the receipt of funds used to pay bond interest and preferred dividends or the timing of the payments themselves are not considered related to the allowance for working capital necessary to carry on the day-to-day activities of its utility business.

Finding

It is the Board's decision that cash working capital each month will be equal to 1.3 times the operating and maintenance expenses excluding charges for transportation by others included in the cost of service for that month.

2.2.4 Other Rate Base Items

Allowance for Premature Reduction of Rate Base

The Company applied to include in Working Capital an item called Allowance for Premature Reduction of Rate Base.

The Company submitted that by Board Order TG-5-79 it is required to use a simple average monthly rate base for toll purposes. The rate base on which the return is calculated is therefore reduced by one-half of the sum of:

- (a) the total monthly charge for depreciation;
- (b) the amortization of prepaid property taxes; and
- (c) the amortization of British Columbia corporation capital taxes.

Westcoast argued that, since these expenses are not reimbursed until the twenty-fourth of the month following the cost of service period, it should be allowed to include in rate base an allowance equal to 1.3 (39 days divided by 30 days) times the monthly total of these expenses.

A number of intervenors objected to the inclusion of this item in rate base. They based their objection on the grounds that depreciation is not a cash expense, that Westcoast in its submission proposed to increase its rate base by an amount greater than the alleged premature reduction, and that Westcoast failed to take into account payments made in advance of depreciation.

The Board recognizes that the timing of rate base additions and deductions does not necessarily coincide with the corresponding receipt and payment of funds. However, over time, these items are considered to offset each other. Any adjustment for such items is therefore not considered to be warranted, and the requested Allowance For Premature Reduction of Rate Base is denied.

Other Items of Working Capital

In addition to the proposed Allowance For Premature Reduction of Rate Base, the Company applied to include the following items in rate base under the heading Working Capital: Employee Benefits Lag; Coloured Gasoline Tax Lag; Special Deposits and Receivables Lag.

The Applicant submitted that the reduction to rate base that it called the Employee Benefits Lag was proposed to reflect the delay between the date of paying employees and the date on which the payroll deductions must be remitted.

The Coloured Gasoline Tax Lag, in the opinion of the Company, is required since the average payment date for this tax is the fifteenth of the month following the cost-of-service period whereas the average revenue receipt date is the twenty-fourth.

Included in the Special Deposits and Receivable Lag are amounts for temporary advances to employees, imprest petty cash funds, special deposits, employee housing loans, deferred relocation expenses, and student loans to children of employees. The CPA argued that the items included under this heading should not be allowed for inclusion in rate base, since these items are virtually identical to those disallowed in the Board's Reasons for Decision of June 1980 with respect to Interprovincial Pipe Line Limited.

In TG-5-79, the Board allowed a working capital provision based on the use of an allowance for operating and maintenance expenses plus average monthly prepaid expenses, average monthly material and supplies inventories, and the average monthly balance of line-pack gas. Although this is only an estimate, the Board considers it sufficient to provide the Company with an amount in rate base which reflects the investment that the Company needs to maintain to carry on the day-to-day activities of its utility business. The Board does not consider it efficacious to try to further refine the calculation of such an allowance and, accordingly, disallows the requested additional items.

CHAPTER 3
RATE OF RETURN

Westcoast applied for the following mid-year deemed capitalization and rate of return before taxes on rate base for the twelve-month test period ending 31 December 1980.

	Mid-Year Amount (\$000)	Ratio (%)	Cost (%)	Cost Component (%)
Bank Debt	43,062	5.71	14.25	0.81
Long-Term Debt	<u>381,371</u>	<u>50.57</u>	9.26	<u>4.68</u>
Total Debt	424,433	56.28	9.77	5.49
Preferred Shares	33,484	4.44	8.50	0.38
Common Equity	<u>296,229</u>	<u>39.28</u>	15.50	<u>6.09</u>
	<u>754,146</u>	<u>100.00</u>		
Rate of Return after Taxes on Rate Base				11.96
Utility Normalized Income Taxes				<u>7.37</u>
Rate of Return before Taxes on Rate Base				<u>19.33</u>

3.1 Capital Structure

In its previous rate application, Westcoast employed a consolidated capital structure excluding debt raised by its subsidiaries as being appropriate for its utility operations. That capital structure treated the Company's equity investments in non-utility subsidiaries as being financed by the same proportion of Westcoast's debt, preferred shares and common equity as were its utility operations. In its September 1979 Decision, the Board found that the common equity component of the proposed capital structure for utility operations was high in relation to the risks faced by those operations. The reasonableness of the capital structure submitted by Westcoast in this proceeding for its utility operations, and more particularly of the common equity component, was once again a major issue.

The currently applied-for deemed capital structure ratios were derived by eliminating from the common equity of

the corporation's capital structure: (1) the Company's share of the undistributed earnings of its subsidiaries and (2) the Company's recorded allowance for funds capitalized in relation to its expenditures made on behalf of Foothills (Yukon). The Applicant maintained that this approach resulted in a capital structure appropriate for its jurisdictional utility operations, having regard to the Company's financial and business risks.

3.1.1 Common Equity

Westcoast contended that in earlier years there had been a necessity to issue debt securities with convertibility features. Exercise of those common equity participation options had increased common equity to a higher proportion than otherwise would have been the case. Because of such convertibility options, the embedded cost of debt was lower than it would have been otherwise and toll payers have benefitted and will continue to benefit from such lower costs.

Mr. Kierans, an expert witness for the Applicant, testified that a ten-year review of the Company's Consolidated Statement of Changes in Financial Position indicated clearly that the timing of the Company's securities issues reflected the development and expansion of its rate base. He maintained that the capital structure reflects fairly not only the costs of financing those assets at the time they were placed in service, but also the historical efficiency of the capital structure given all the conditions prevailing in the capital markets over the period and the actual and perceived financial state of the Company.

Dr. Sherwin, the Company's other expert rate of return witness, stated that the concept of an optimal capital structure is a theoretical concept which is difficult to adhere to, that capital structures reflect historical developments which cannot be rapidly altered, and that what constitutes an optimal capital structure changes over time. With these

factors in mind, Dr. Sherwin indicated, with respect to Westcoast, that a deemed capital structure used for pipeline operations should be consistent with the business risks of the utility and that the implicit common equity ratio for the non-pipeline operations should be reasonably commensurate with the higher risks of those operations. As discussed in the section on Rate of Return on Common Equity, both Dr. Sherwin and Mr. Kierans believed that Westcoast had marginally greater business risks than Nova and TransCanada.

Dr. Sherwin and Mr. Kierans both testified that a reasonable common equity ratio for Westcoast's jurisdictional utility operations, having regard to the business risks of those operations, was in the range of 35 to 40 percent.

With respect to possible reductions of equity capital in relation to a requirement to maintain financial flexibility, Mr. Kierans testified that it would be unwise for the Company to declare an "extra" dividend or tender for and retire \$25-\$40 million of its common equity to achieve a smaller equity component. Mr. Kierans expressed the opinion that higher interest costs impact on issuance tests and restrict the size of future debt offerings and that there is a possibility that utilities may be required to issue floating rate funded debt. Mr. Kierans also expressed the opinion that future financings for jurisdictional asset growth purposes will be clearly limited to debt issues.

Dr. Ileo, an expert rate-of-return witness for the BCPC, recommended a capital structure for Westcoast's jurisdictional utility operations containing a 33.75 percent common equity ratio. In arriving at his recommended ratio Dr. Ileo claimed that one should first determine a reasonable capital structure for the Applicant's non-utility investments by having regard to the average capital structure of a group of industrial companies. Having determined that capital structure, he maintained that the remaining financing sources of Westcoast's

consolidated capital structure would, by deduction, be reasonable for the Company's jurisdictional utility operations. In support of this approach, Dr. Ileo contended that it was appropriate to start with a non-utility capital structure which could be viewed as reasonable because it was derived by comparison with industrial firms whose capital structures are driven by competitive market forces.

Dr. Ileo indicated that industrial companies had capital structures, on average, containing approximately 30 percent debt and 70 percent equity. He maintained that Westcoast's non-utility investments had risks similar to industrials and, therefore, concluded that a 70 percent equity ratio was appropriate for Westcoast's non-utility investments and that, by deduction, the common equity ratio for the jurisdictional operations should be 33.75 percent.

Mr. Sharwood, another expert witness for the BCPC, testified that, while he had not specifically studied the question of an appropriate equity ratio for the non-utility investments, he was more inclined to concur with the Company's position than that put forth by Dr. Ileo. He further stated in his direct testimony that comparing debt-equity ratios can be misleading primarily because appraisal values can be greater than book values.

The expert rate-of-return witness for B.C. Hydro, Dr. Smith, suggested that an amount equal to the entire book value of the Company's non-utility investments be deducted from the common equity of the corporate capital structure and that no amount of bank debt be included in the deemed capital structure for jurisdictional utility operations. On that basis, Dr. Smith recommended a capital structure containing a 33.7 percent common equity ratio. Further, Dr. Smith maintained that Westcoast's proposed adjustment from the currently approved common equity ratio of 39.95 percent to 39.28 percent is insufficient to reduce the disadvantages of the high equity ratio and to avoid what she

considered to be a subsidy to nonjurisdictional investments by ratepayers.

It appeared in cross-examination that acceptance of the strict application of Dr. Smith's suggested approach, given the Applicant's anticipated future \$730 million involvement in Foothills (Yukon)'s mainline project, may imply the use of inappropriate proportions of debt for the Company's utility system in the future.

Counsel for the Attorney General of British Columbia suggested that the following proportions of equity were used respectively by Westcoast in financing each non-jurisdictional investment: Westcoast Petroleum Ltd. - 72.8 percent; Pacific Northern Gas Ltd. - 54 percent; Saratoga Processing Company Limited - 80 percent; Vancal Properties Ltd. - 6 percent; Westcoast's inactive subsidiaries - 100 percent. From those assumed non-utility investment equity financing ratios, he recommended a capital structure containing 33.50 percent common equity for Westcoast's jurisdictional utility operations.

The CPA and the COFI argued that the applied-for common equity ratio was too high and recommended ratios in the range of 30 to 35 percent and 32 to 35 percent respectively for Westcoast's jurisdictional utility operations.

In summary, intervenor recommendations fell within a range of 30 to 35 percent. The Applicant's expert witnesses believed that a 35 to 40 percent range was reasonable and adopted the Applicant's applied-for ratio of 39.28 percent.

The Board notes that Dr. Sherwin lowered his otherwise recommended rate of return on common equity because the applied-for common equity ratio was near the upper end of the 35 to 40 percent range that he considered to be reasonable.

Dr. Sherwin maintained that common equity ratios are related to levels of business risk. He concluded, as did Mr. Kierans, that the business risks of Westcoast's utility operations were marginally greater than those faced by the

utility operations of Nova and TransCanada. The Board notes that the approved common equity ratios for these utilities are 32 percent and 30 percent respectively. The Board does not believe that the business risks of Westcoast's utility operations are significantly greater than those of Nova and TransCanada. Consequently, the Board believes that the applied-for common equity ratio is somewhat high.

With respect to the intervenors' evidence, the Board sees some persuasive elements in the positions put forth by Dr. Ileo and the counsel for the Attorney General of British Columbia. The Board agrees with Dr. Smith that Westcoast's adjustment from the currently approved common equity ratio of 39.95 percent to 39.28 percent would appear to be insufficient to reduce the disadvantages of the high equity ratio and to avoid a subsidy to non-jurisdictional investments by ratepayers.

The Board notes the points raised by Dr. Sherwin and Mr. Kierans, that it is difficult for a company to rapidly alter its capital structure and that Westcoast's common equity ratio is influenced by historical factors related to the Company's past risk position and past capital market conditions. In this regard, the Board has given some weight to the Applicant's position respecting the effects of its convertible debt issued in earlier years.

Having carefully considered all of the evidence on this matter, the Board finds that a common equity ratio of 35 percent is reasonable for the Company's jurisdictional utility operations for the test period.

3.1.2 Bank Debt

The Applicant submitted that the long-term debt market in late 1979 and early 1980 did not allow for the issuance of long-term debt at an attractive rate under reasonable terms and covenant patterns, and that the use of bank debt had allowed Westcoast to time its entry into the long-term debt market to obtain funds on a 20-year basis on reasonable terms. Since the

cost disadvantages of short-term bank debt had been absorbed by Westcoast's shareholders to minimize the cost of long-term debt, the Applicant maintained that bank debt should be included in the capital structure.

Dr. Smith recommended that short-term debt not be included in the capital structure because it did not represent permanent financing and, therefore, should not be considered in the financing of permanent assets.

Dr. Ileo, on the other hand, agreed with the Applicant's position, but only on the basis that all short-term debt be included in the capital structure on a continuing basis for rate-making purposes. In support of his position, Dr. Ileo suggested that business, regulated or otherwise, continually relies on short-term debt as a source of capital, which not only enables a company to keep its credit lines open but allows it to maintain financial flexibility and minimize its cost of capital.

The Board is of the opinion that, in the present circumstances, particularly where utility assets have been financed by short-term debt, it is appropriate to include short-term bank debt in the capital structure.

3.2 Cost of Bank Debt

The Applicant computed a cost rate for bank debt of 14.25 percent. Evidence concerning actual experience indicated that this rate should be revised to 13.92 percent.

The Board approves a cost rate for bank debt of 13.92 percent.

3.3 Cost of Long-Term Debt

The Applicant calculated its embedded cost of long-term debt, excluding foreign exchange, to be 9.26 percent as at mid-year 1979-80, based on an "actuarial" method.

A group of intervenors questioned the Applicant's method of calculating its embedded cost of long-term debt. The Applicant submitted a "financial statement" method of calculating

its embedded cost of long-term debt which also yielded a cost rate of 9.26 percent.

The Board finds the Applicant's estimate of 9.26 percent to be acceptable.

3.4 Cost of Preferred Shares

The Applicant's submitted 8.50 percent cost of preferred share capital was not at issue in these proceedings. The Board approves the Applicant's estimate.

3.5 Rate of Return on Common Equity

The Applicant requested a rate of return of 15.50 percent on its proposed common equity ratio of 39.28 percent.

3.5.1 Business Risks

Dr. Sherwin stated that, on net balance, the business risks have remained unchanged since the 1979 Westcoast rate proceedings, except for regulatory risks relating to an inability to achieve the allowed return due to "tax benefit sharing". Further, he assumed that "tax benefit sharing" would be obviated and stated that his equity return recommendation, compared with that which he recommended in the previous proceeding, was higher due only to the rise in the opportunity cost of capital, as reflected in the higher interest rates and the higher level of achieved and prospective returns of Canadian industrials.

Dr. Sherwin was of the opinion that Westcoast's utility business risks, while not significantly different from those of TransCanada and Nova, were greater because Westcoast's supply is less extensive and less diverse and Westcoast's physical risks are greater due to a more rugged terrain, the absence of full looping and the fact that about 80 percent of throughput volumes is processed by only four plants.

With regard to demand risks, Dr. Sherwin testified that there has been some increase in demand risks due to the rise in export price resulting in a decline in export volumes which may trigger take-or-pay obligations. However, he felt that these higher demand risks were in a large degree offset by the continued improvement in supply.

With respect to regulatory risks Dr. Sherwin believed that the Board, by combining the regulatory framework of the BCPC Agreement with its own surveillance, had created a regulatory environment that essentially placed Westcoast at parity with Nova and TransCanada. However, he maintained that parity may not have been achieved because of the implementation of "tax benefit sharing".

Mr. Kierans expressed similar views to those of Dr. Sherwin and also referred to the possibility of developments that could cause the Government of British Columbia to instruct the BCPC to renegotiate aspects of the Agreement that could have an adverse impact on the Company. Further, he suggested that investors tend to "look through" the Agreement.

Mr. Sharwood was of the opinion that, whatever marginally higher risks exist because of supply, demand and physical risks over other utilities to which Westcoast is usually compared, those risks are more than compensated for by the existence of the BCPC Agreement and, more particularly, its cost of service arrangement. In contrast to Mr. Kierans, he indicated that investors do not "look through" the BCPC Agreement and made reference to opinions of investment dealers.

Dr. Ileo suggested that the Company's improved gas supply situation is beneficial in that it facilitates expansion and he was of the opinion that the Board's method of regulating Westcoast is in itself a risk-minimizing factor, since investors now have greater certainty as to the method for determining the costs of service under the BCPC Agreement.

On an overall basis the Board does not consider Westcoast's utility business risks to be significantly different from those faced by the pipeline operations of TransCanada or Nova. In arriving at this conclusion, the Board's main consideration relates to the existence of the BCPC Agreement. As the Board found in its last decision, should a significant change

occur in the Agreement, the Board would wish to review its decision in these proceedings.

3.5.2 Comparable Earnings Test

Dr. Sherwin recommended a rate of return of 15.50 percent given the Company's applied-for common equity ratio of 39.28 percent. If Westcoast's common equity ratio were 37.50 percent Dr. Sherwin stated that he would have recommended a rate of return of 16 percent.

In deriving his recommendation Dr. Sherwin placed primary reliance on comparisons of returns on book equity earned by industrial companies over the period 1977 to 1979. He maintained that that period is representative of prospective conditions and that it would be inappropriate to refer solely to the 1979 level of book earnings because that level may not be sustained. Further, he contended that a five-year period was not appropriate because of inventory profits in 1974 and 1975, the impact of the Anti-Inflation Board's controls and the most severe post-war recession; and that a longer reference period would be inappropriate because it would not reflect the rising trend in interest rates and level of profits. Dr. Sherwin maintained that one must look at "investment grade" industrial earnings rather than regulated utility earnings because the latter exercise would constitute circular reasoning.

Dr. Sherwin chose two groups of Canadian industrials which he maintained were selected on the basis of having stability comparable to that of Westcoast. The first group consisted of two sets of Canadian industrial companies. One set consisted of companies ranked A or better by Standard and Poor's (S & P) and "very conservative" by Canadian Business Service (CBS) if not ranked by S & P. The other set consisted of firms ranked A- by S & P and "conservative" by CBS if not ranked by S & P. These two sets of firms were referred to as high-grade and medium-grade respectively and the entire group was termed

investment grade. Dr. Sherwin found that the median returns for 1977 to 1979 were 15.9 percent and that the corresponding market-to-book ratios averaged 113 percent.

With respect to market-to-book ratios, Dr. Sherwin stated that since costs of financing and market pressure are typically 10 percent and there needs to be some leeway for market fluctuations, an earnings level that falls short of providing a market-to-book ratio of 115 to 120 percent is likely to cause difficulties in attracting new equity capital without dilution of existing capital. In cross-examination, Dr. Sherwin testified that, even though Westcoast would not likely be issuing equity capital in the near future, the Company should be allowed a margin above book value which corresponds to the margin that industrials of comparable risk can or are likely to achieve.

Dr. Sherwin admitted that the selection criteria necessarily lead to a selection of high earners because the A and A- rankings, for instance, are influenced by the level of earned returns. Further, he conceded that six of the fourteen high-grade industrials are oil companies whose profit levels may not be representative of the competitive norm.

Recognizing the above-noted limitations of this group, Dr. Sherwin chose companies out of a second group, comprising 105 Canadian industrials (arrayed with respect to their coefficients of variation (COV's) over ten-year and seven-year periods ending in 1978) whose COV's were in the lower one-third of the array. This choice was made on the grounds that utilities with seven-year or ten-year COV's below 20 percent should be regarded as having approximately comparable stability to the lower third of industrials. Giving consideration to both medians and averages Dr. Sherwin found that the returns for the lower third, over the period 1977 to 1979, were 15.9 percent and the corresponding market-to-book ratio averaged 120 percent. Dr. Sherwin acknowledged that as a measure of stability, the COV is

sensitive to levels of earnings and that companies which exhibit low COV's are more likely to be high earners. However, he also pointed out that companies which experience stable but low earnings are not as desirable, as investments, as those whose earnings fluctuate around a higher level. On the other hand, he noted that the present mode of regulation virtually eliminates variability of return for Westcoast.

With regard to utility earnings, Dr. Sherwin reviewed book returns on equity for Canadian gas pipelines but maintained that those returns served no useful purpose because of significant non-utility influences. He noted that the average returns for four gas distributors rose from 15.2 percent in 1977 to 16.4 percent in 1979 on an approximately 32 percent equity ratio with average market-to-book ratios of 129 percent and two electrics showed a rise in returns from 14.7 percent in 1977 to 15.6 percent in 1978, declining to 15.3 percent in 1979, on an average equity ratio of about 35 percent with a market-to-book ratio of 117 on average. The conclusion he reached concerning utilities was that high-grade public utilities require a return of 15.5 on a 35 percent equity ratio.

The Board notes the qualifications that Dr. Sherwin placed on his comparable earnings evidence; i.e., that there is some inherent tendency for comparisons to be made with companies exhibiting higher levels of earnings. The Board has taken these qualifications into account in assessing the weight to be given this evidence.

3.5.3 Discounted-Cash-Flow Approach

Estimates by most expert witnesses of the basic discounted-cash-flow(DCF)-derived cost of common equity for Westcoast fell within a range of 13.7 to 14.1 percent.

Dr. Smith recommended a DCF-derived rate of return of 13.7 percent. Because the DCF approach is tied to market values rather than book values, its direct application infers the cost

of capital for the corporation as a whole and not just the jurisdictional cost of capital. Dr. Smith maintained that her observed dividend yield matched investor perceptions of the utility operations and disagreed with Dr. Sherwin's contention that Westcoast's dividend yield reflects influences of non-utility potential. Mr. Sharwood testified that he would agree with both Dr. Sherwin and Mr. Kierans that the activity of the Company's stock, relative to other utilities, was more related to its non-jurisdictional activity than its jurisdictional activity.

Mr. Kierans testified that his DCF estimate of around 14.01 percent translated to a required rate of return on book common equity of 15.5 percent. Dr. Sherwin adjusted his basic DCF estimate of 13.7 percent to a 15.2 percent required rate of return on book common equity because of such factors as flotation costs, market pressure and price fluctuations. While he stated that an appropriate market-to-book ratio was 115 to 120 percent, in making his adjustment to his basic DCF cost rate estimate of 13.7 percent he assumed a required market-to-book ratio of 120. Had Dr. Sherwin used a required market-to-book ratio of 115, his adjusted DCF rate would have been 14.87 percent. Mr. Sharwood agreed with Dr. Sherwin that it is important to the financial integrity of a corporation to maintain a market value in excess of book value but stated that asking for a degree of precision is presumptuous.

The Board believes that DCF method of determining the cost of common equity capital has some merit and should be given consideration notwithstanding that stock prices are sometimes susceptible to erratic movements based on factors that may be unrelated to a particular stock's anticipated performance, the difficulty of segregating the jurisdictional utility operations from the total operations of the corporate entity, and the difficulty in accurately judging future growth rates.

3.5.4 Regression Analysis

Dr. Ileo recommended a rate of return on book common equity of 13.0 or 13.3 percent for Westcoast's jurisdictional operations given a common equity ratio of 33.75 percent. In reaching his recommendation Dr. Ileo referred to various regression analyses he had prepared.

The Board has some difficulty in accepting the results of those analyses and their implications for regulatory purposes that higher equity ratios dictate higher rates of return.

3.5.5 Board Findings

Business risk and the main cost of capital measurement techniques presented by expert witnesses have been discussed separately above. The Board is of the view that all of these methods have built-in limitations and necessarily involve a substantial exercise of judgement in their application in any particular case.

While not presenting direct evidence, the CPA recommended a rate of return of 15 percent on a common equity ratio of 30 to 35 percent and the Attorney General of B.C. recommended a rate of return of 14.50 percent on a common equity ratio of 32.50 percent. Other intervenors recommended no change in the overall rate of return on rate base on the grounds that the stock of the Company is performing well in the market place at the present time. The Applicant, including its expert witnesses, testified that the rate of return on common equity should be increased over that allowed in the previous proceeding in line with a general increase in the cost of capital.

The Board believes that at present the general cost of capital is particularly high but notes that a number of witnesses were of the opinion that the current levels will not be sustained in 1981.

After careful examination of all the evidence on this matter the Board finds that a 15 percent rate of return on a common equity ratio of 35 percent is fair and reasonable.

3.6 Overall Deemed Capital Structure and Rate of Return on Rate Base

The determination of a deemed capital structure for rate making purposes requires not only the selection of an appropriate common equity ratio but also a determination of the total capital as well as appropriate proportions of other classes of capital comprising that total.

With respect to the determination of an overall capital structure, Dr. Sherwin testified that in the 1980 TransCanada proceeding he had recommended that the total capital for rate-making purposes be set equal to total rate base with 32.5 percent of that total being allocated to common equity and the remaining 67.5 percent being made up, first, by the entire funded debt and preferred equity which were in place prior to TransCanada's diversification and, second, by assumed new debt. However, he maintained that a similar approach would be inappropriate for Westcoast because:

- (a) the Company continues to be primarily engaged in utility-related activities;
- (b) the non-utility investments were made over a span of years so that they may reasonably be presumed to have been financed in part by the existing funded debt and preferred stock; and
- (c) the recent recourse to bank debt was primarily for utility purposes.

With respect to the subject of subsidization of non-utility activities by jurisdictional utility operations, Dr. Sherwin said, "With respect to future large scale financings, considerations of fairness may render it desirable to balance the impact of a decline in Westcoast's equity ratio with the potential rise in its embedded cost of debt."

On the same subject, Mr. Kierans testified that problems associated with combining jurisdictional and non-jurisdictional activities within one corporate entity can best

be resolved by deeming a capital structure which most efficiently relates to the business risks associated with the jurisdictional activities of the Company and by limiting the scrutiny of non-jurisdictional operations to satisfy one basic condition - that the financing of such activities does not increase the cost of capital supporting the jurisdictional assets. He concluded that non-jurisdictional activities have not yet influenced the Company's cost of capital.

Apart from various specific considerations, intervenors expressed the general concern that a capital structure be established for ratemaking purposes which avoided subsidization of the Company's non-utility activities.

It is the Board's view that the setting of total capitalization equal to utility assets, together with an appropriate equity ratio, constitutes a fundamental step in ensuring that the ratepayer does not subsidize non-utility investments or that the costs of capital for ratemaking purposes are not affected by non-utility activities. Although no evidence was found that the cost rates of individual elements of capital have been affected by non-utility activities, the onus will be on the Company to demonstrate, where necessary, that this will continue to be the case.

The Board has decided that the total capital for rate making purposes should be equal to the total of the average amount of rate base (net of deferred income taxes) and construction-work-in-progress over the test period in line with the submission of the Applicant. Furthermore, the Board has determined that 35 percent of this total capital should be composed of common equity. The balance of the required capital will consist of preferred equity, bank debt and long-term debt capital in approximately the same proportions as each is represented in the total amount of preferred equity, bank debt and long-term debt capital existing within the corporation.

As a result of the above decision, combined with the Board's findings in respect of other rate of return matters, the Board finds that the allowable Rate of Return (exclusive of income taxes) on Rate Base is 11.51 percent.

One-twelfth of this percent, namely 0.959166 percent, is the rate to be applied to the allowable rate base (net of deferred income taxes) each month in order to determine the dollar value of the Return on Rate Base to be included in the allowable cost of service.

The derivation of the allowed Rate of Return on Rate Base is set forth below.

	Amount (\$000)	Ratio (%)	Cost (%)	Cost Component (%)
Bank Debt	45,019	5.96	13.92	0.83
Long-Term Debt	409,929	54.28	9.26	5.03
Total Debt	454,948	60.24	9.73	5.86
Preferred Shares	35,985	4.76	8.50	0.40
Common Equity	264,349	35.00	15.00	5.25
	<u>755,282</u> (a)	<u>100.00</u>		
Rate of Return on Rate Base				<u>11.51</u>

(a) This total capital amount is the same as that submitted by the Applicant except for the adjustment to the deferred tax amount deducted from rate base. See Appendix B.

CHAPTER 4
INCOME TAXES

4.1 Normalized Taxes

4.1.1 Background

In its 1979 Decision, the Board employed a pre-tax rate of return* on rate base in determining the amounts of return and normalized taxes to be collected by Westcoast in its monthly cost of service.

In determining this rate, the Board approved the concept of an allocation of certain items of income and expense (essentially interest expense and various permanent difference amounts) as between Westcoast's utility and non-utility activities. However, the Board required that one-half of the net of such amounts allocated to non-utility activities by the Company be brought back into the calculation of normalized taxes which formed the basis for calculating the tax rate or factor to be incorporated in the pre-tax rate of return on rate base. This approach was described as "tax benefit sharing" and, on a net basis, its effect was to reduce the tax rate or factor below that which would have applied had the Company's allocation been fully accepted.

4.1.2 Applicant's Position

In its current application, Westcoast requested that the Board discontinue "tax benefit sharing" and compute a tax factor for rate-making purposes that would not include any of those amounts (notably interest expense) which it had allocated

* This pre-tax rate of return was composed of the sum of (a) the rate of return on rate base and (b) the product obtained by multiplying the combined weighted average costs of preferred and common equity by a factor designed to provide for the taxes associated with these costs, after adjustment for permanent differences.

to its non-utility activities.*

In support of this request, Westcoast submitted that "tax benefit sharing":

- causes ratepayers to receive one-half of the benefit of a tax deduction without paying the expense which gave rise to it;
- results in cross-subsidization in that the tax expense to be paid by ratepayers is reduced below what it would otherwise be had non-utility investments not been made;
- results in a permanent reduction in the return Westcoast earns on its non-utility investments;
- retroactively alters the conditions assumed by the Company at the time the initial investments in non-utility operations were made; and
- denies the same treatment to Westcoast's shareholders that is available to shareholders of other companies under the Income Tax Act.

During the hearing, Westcoast took the position that "tax benefit sharing" should be eliminated provided a capital structure is determined which avoids cross-subsidization and which is commensurate with the business risks of its utility operations.

4.1.3 Intervenors' Positions

The Attorney General of British Columbia contended that an appropriate capital structure for Westcoast's utility operations should contain a 33.5 percent deemed common equity

* The basis of this allocation of items of income and expense was the proportion that each of utility and non-utility investments formed of Westcoast's adjusted corporate capitalization. Those items not considered allocable by the Company were, therefore, completely associated with either utility or non-utility activities.

component. In recommending the maintenance of the 14.25 percent rate of return on common equity (allowed in the Board's 1979 Decision on an approximate 40 percent common equity ratio), the AGBC took the position that it was willing to accept that the Board should design its Order so as to effectively permit Westcoast to earn the full 14.25 percent rate of return.

B.C. Hydro's rate-of-return witness stated in her prepared evidence that "tax benefit sharing" should not be imposed provided the entire carrying value of Westcoast's non-utility investments is deducted from its corporate common equity (in arriving at a capital structure for rate-making purposes) so as to avoid having any return upon Westcoast's non-utility equity investment being provided by ratepayers.

The BCPC stated that it did not oppose the position taken by Westcoast, essentially on the condition that the unregulated activities are not subsidized by the utility customers. In taking this position, the BCPC stated that it saw nothing wrong with the principal of "tax benefit sharing" because any tax deduction or benefit generated by non-utility activities could only be used against utility income. However, the BCPC stated that, as a practical matter, it saw some advantage in the elimination of "tax benefit sharing" insofar as it prevented Westcoast from earning the allowed rate of return, thus raising the argument that some compensating adjustment should be made which, if accepted, would serve to complicate or hinder the use of the comparable earnings test in determining an appropriate rate of return on equity.

The CPA stated that the revenues generated by the utility made the financing of Westcoast's non-utility investments possible and that without these revenues the expenses allocated to the non-utility investments would have no income to shelter. Nevertheless, it took the position that the "tax benefit sharing" concept should be retained by the Board

only if it concluded that insufficient information was available to arrive at an appropriate deemed capital structure for Westcoast's jurisdictional operations.

The COFI stated that it did not oppose the "stand alone" concept put forward by Westcoast and that the elimination of cross-subsidization through the deeming of an appropriate capital structure may reduce the need for "tax benefit sharing" to a point where it is not necessary. However, in spite of this view, the COFI took the position that the Board should give some consideration to the continuance of "tax benefit sharing" because of the benefits the non-utility activities received by way of their association with the utility operations. The benefits referred to by the COFI included the credit strength of the utility operation which assisted in the financing of the non-utility investments together with the relatively assured and early recovery of non-utility associated tax deductions, made possible through their application against utility income.

4.1.4 Views of the Board

The Board has taken careful account of all evidence presented by both the Applicant and intervenors. The Board does not necessarily subscribe to all of the arguments advanced. However, the Board agrees with the weight given by parties to capital structure considerations and views the establishment of an appropriate capital structure as fundamental to the equitable resolution of the "tax benefit sharing" issue. The Board has determined, as set forth in Chapter 3, a deemed capital structure which it believes, at present, serves to minimize the pre-tax cost of capital to ratepayers and to avoid a subsidy to non-utility investments. In the circumstances of this case, it is the opinion of the Board that it would not be appropriate to order a tax treatment for ratemaking purposes which the evidence indicated, inter alia, could only benefit the ratepayers at the expense of the

shareholders and would reduce the cost of service borne by ratepayers to a level below that which would have been the case had non-utility investments not been made.

Accordingly, the Board approves the Company's request that the provision for normalized income taxes be computed in a manner which precludes "tax benefit sharing". As a result of this decision, the Board finds that one-twelfth of the rate of 6.14 percent*, namely .511666 percent, is the rate to be applied to the allowable rate base (net of deferred income taxes) each month in order to determine the dollar amount of normalized income taxes to be included in the allowable cost of service.

The Applicant maintained that the Board erred when it applied the "tax benefit sharing" concept in TG-5-79. Westcoast contended that the Board failed to take into account, in calculating the effective normalized tax rate, "taxable income" attributed by the Company to its non-jurisdictional activities, i.e., the allowance for funds capitalized (AFC) with respect to the Company's investment in Foothills (Yukon).

Evidence indicated that Westcoast has not, in fact, received any revenue subject to income tax from Foothills (Yukon), and that the "taxable income" referred to by the Applicant was related to a booked income in respect of capitalized debt and equity financing costs.

The Board's finding on the "tax benefit sharing" issue obviates the necessity for considering the issue of the taxable status of AFC in respect of Foothills (Yukon) in determining the normalized income tax rate.

4.2 Deferred Taxes

In its 1979 Decision, the Board ordered that the amount of deferred taxes to be deducted by Westcoast in

* See Appendix B page 4.

determining its rate base be computed by taking the difference between normalized taxes collected in the cost of service and taxes payable. This latter term was effectively defined to be the amount of income taxes which Westcoast as a corporation was liable to pay the taxation authorities in a given year, because there appeared to be no significant taxes payable applicable to the non-utility operations of Westcoast.

In its current Application, the Company adduced evidence which indicated that it would not pay income taxes either for 1979 or for 1980 essentially by reason of the expenditures made under its agency arrangement with Foothills (Yukon). The Company requested, however, that these expenditures be excluded from the computation of the amount of taxes payable to be used in calculating the deferred taxes to be deducted in determining rate base. In short, the Company requested that taxes payable be computed on the same "stand alone" basis as had been used to arrive at the applied-for normalized tax rate or factor discussed previously.

The line of reasoning put forward by the Applicant in support of this request was much the same as that advanced with respect to the issue of "tax benefit sharing". Westcoast submitted that the method prescribed by the Board in its 1979 Decision:

- causes cross-subsidization insofar as it transfers the opportunity to earn a return on taxes deferred by reason of the Foothills expenditures from the shareholders to the ratepayers, thereby reducing the cost of service below what it would have been in the absence of such expenditures;
- is inappropriate in that the ratepayers did not pay the expenditures which gave rise to the deferred taxes and;
- is contrary to the policy embodied in the Income Tax Act.

Although most intervenors did not specifically address the issue, it appears to the Board that their position in relation to "tax benefit sharing" was intended to be equally applicable to the calculation of the deferred tax balance to be deducted from the rate base.

The Company also asked for approval to adjust the accumulated deferred tax balance, effective 1 April 1980, so as to reduce it to the lower level which would have existed had the Board not ordered the method of computation it did in the 1979 Decision.

Several intervenors expressed opposition to this request to adjust the accumulated deferred tax balance for rate base determination purposes. The principal argument underlying this opposition was that such an adjustment constitutes a change of a retroactive nature.

The Board is of the view that the resolution of the deferred tax issue follows from and should be consistent with the decision it has taken in regard to "tax benefit sharing". For the same reasons, the Board approves the Company's request to compute the amount of deferred taxes to be deducted in determining rate base so as to reflect an allocation of items of income and expense as between utility and non-utility activities. The details of the implementation of this decision with respect to the test year are set forth in Appendix B.

The Board has decided to allow the applied-for adjustment to the accumulated deferred tax balance. As prescribed in Order TG-5-79, Westcoast is required to deduct accumulated deferred taxes for the previous month in determining the rate base for a current month. Therefore, to ensure that the Board's decision to allow the applied-for adjustment is reflected in the Company's tolls for the month of January 1981, Westcoast shall make the adjustment to the accumulated deferred tax balance as at 31 December 1980.

As this adjustment will not affect the cost of service determined in accordance with Order No. TG-5-79 for those months prior to January 1981, the Board does not consider the approved adjustment to be retroactive in nature.

4.3 Five Percent Corporate Surtax

Recently, the Federal Government announced its intention, by a Notice of Ways and Means Motion, to impose a temporary five percent surtax on the Federal Part 1 tax payable by corporations, effective for the two-year period 1 January 1980 to 31 December 1981.

Westcoast initially requested that this surtax be reflected in the normalized tax rate or factor discussed previously, based upon the argument that generally accepted accounting principles require that normalized taxes be calculated at currently effective rates. Intervenors objected to this proposal in light of the probability that the Company would not pay income tax in respect of 1979 or 1980. During the hearing, the Company accepted that the normalized tax rate not reflect any surtax, provided that approval be given to collect any surtax that might actually be incurred.

Accordingly, the Board has decided that the normalized tax rate will not reflect the temporary five percent corporate surtax. The Board has also decided that, should the Company be required to pay any surtax, it may then apply to the Board for permission to have this cost included in its rates.

CHAPTER 5
TAXES OTHER THAN INCOME TAXES

5.1 British Columbia Corporation Capital Tax

The Company and the intervenors agreed that a portion of the British Columbia Corporation Capital Tax should be allocated to the non-utility operation since the investment allowance provided by the Corporation Capital Tax Act for investments in subsidiaries is less than the book value. Westcoast proposed a formula to determine the Corporation Capital Tax applicable to non-utility operations.

The intervenors were in general agreement with the proposed formula. However, the BCPC proposed that, in determining the total of non-utility investments to be used in the formula, Westcoast should use the greater of cost or book value, since this is the value to be used in calculating the investment allowance under the Corporation Capital Tax Act of British Columbia.

It is the Board's view that, in general, the formula proposed by Westcoast to allocate a portion of the British Columbia Corporation Capital Tax is acceptable. However, in determining the total of non-utility investments to be used in the formula, it is the Board's decision that the Company use the greater of cost or book value, which is consistent with the method of calculation under the Corporation Capital Tax Act of British Columbia.

CHAPTER 6
DISPOSITION

The Board's decisions on the matters raised in paragraph 10 of Westcoast's application of 31 March 1980, as amended, as well as on the other issues respecting the Company's rate base, are set out in the foregoing chapters of these Reasons for Decision.

There were two other matters raised in the course of the hearing relating to the order to be made by the Board as a result of these proceedings. In paragraph 10 of its application, Westcoast requested the Board to make an order changing the manner in which the Company calculates its tolls effective 1 April 1980, which date coincides with the day that Westcoast filed its application with the Board. The intervenors opposed this request on the basis that, in the absence of express authority in the NEB Act, the Board does not have the power to make its order retroactive to the date of the filing of the application. Having considered the arguments advanced by all parties on this question, the Board has concluded that it does not have the power under the NEB Act to make its order retroactive to 1 April 1980 as requested by the Company.

The second matter, also raised by Westcoast, relates to the form of the order to be made by the Board. In final argument, the Company requested that the Board issue an entirely new order prescribing the tolls to be charged rather than merely amending Order No. TG-5-79. Westcoast also requested, however, that any new order contain appropriate transitional provisions to preserve its right under Order No. TG-5-79 to apply to the Board for recovery of any amounts by which Operating and Maintenance Expenses for the period from 1 July 1979 to 30 June 1980 exceed the approved budgets for that period. The Board is of the opinion that, as the application by Westcoast raised only certain limited aspects of the overall method of determining the Company's tolls under

Order No. TG-5-79, and as there were many other significant aspects which were not at issue during the hearing, it would be more appropriate, in the circumstances of this case, to proceed by way of amending Order No. TG-5-79 rather than by issuing an entirely new order.

In the course of cross-examining certain of the Company's witnesses, B.C. Hydro raised the question of whether there was any unjust discrimination within the meaning of section 55 of the NEB Act by reason of the difference in the times by which B.C. Hydro and Pacific Northern Gas Ltd. are required to pay Westcoast for gas delivered in any month. The terms of payment for gas purchased from Westcoast are contained in the contracts by which B.C. Hydro and Pacific Northern Gas Ltd. purchase gas from the Company. Those contracts are filed with the Board under subsection 51(2) of the NEB Act and are deemed to be tariffs. There was no application before the Board by any party in respect of those tariffs. Westcoast's application related solely to the determination of its tolls under Order No. TG-5-79. In the Board's view, if any party wishes to raise questions respecting the subsection 51(2) tariffs, the appropriate application should be made to the Board for an order respecting those tariffs.

Similarly, in the course of the hearing, B.C. Hydro raised the subject of the depreciation rates authorized by the Board in Order No. TG-5-79 for toll purposes. No indication had been given prior to the hearing by B.C. Hydro that it wished to pursue that issue. Where parties wish to raise any issues respecting Westcoast's tolls, a complaint should be made as contemplated by Order No. TG-5-79 or an application otherwise made under Part IV of the Act to put such matters at issue. In this way, questions respecting Westcoast's tolls may be dealt with in an orderly fashion on proper notice to other interested parties.

Order No AO-4-TG-5-79, which is set out as Appendix C to these Reasons, together with the foregoing constitute our decision and Reasons for Decision on the application by Westcoast Transmission Company Limited under Part IV of the National Energy Board Act. The Board is satisfied that, with the changes in the manner of calculating Westcoast's tolls set out in the order, the tolls to be charged by the company effective 1 January 1981 will be just and reasonable.

L.M. Thur

L.M. Thur
Presiding Member

R.B. Horner

R.B. Horner
Member

DISSENTING OPINION OF
MR. J.R. HARDIE

I have been completely involved in the decisions reached by the majority of the Panel, and I concur with the decisions as set out hereinbefore, including the decision with respect to the handling of the 5 percent temporary Federal surtax. However, I dissent on the treatment of the calculation of income taxes to be included in cost of service and the calculation of the amount of deferred income taxes to be deducted from rate base.

In its 1979 Decision the Board required that, in arriving at the effective tax rate to be utilized in determining the amount of income tax to be included in the cost of service, 50 percent of the interest paid in respect of the debt which was deemed to be allocated to the non-utility activities of Westcoast in its capital structure and 50 percent of certain "permanent difference" amounts allocated to non-utility activities must be deducted in calculating the taxable income of the utility. The Decision further required that the deferred tax to be deducted from the rate base to arrive at the amount on which Westcoast should be allowed a rate of return would be the entire amount of the Company's deferred taxes, since there was no significant non-utility taxable income.

Westcoast stated in its evidence and in argument that it disagreed with these two decisions. An analysis of the evidence and the argument seems to indicate that the main reason for the disagreement was that Westcoast's earnings are less as a result of these two decisions than they would have been if these matters had been decided otherwise.

In arriving at the Decision made in 1979 the whole question of income tax and its calculation was thoroughly examined, and the Board was fully aware of the consequences on

Westcoast of the treatment of the various items included therein. It is true that Westcoast's earnings are less than they would have been if it had not been required to do as the Board directed, but it cannot be implied that this result was not known to the Board at the time of its Decision. Furthermore, there was no evidence presented that indicated that the situation had changed whereby Westcoast now has any significant taxable income from its non-jurisdictional operations. Accordingly, I do not consider that there are sufficient grounds to change the 1979 decision. Therefore, the so-called income tax sharing should be continued, and the amount of deferred taxes to be deducted in determining the rate base of Westcoast should be the total amount of deferred taxes of Westcoast Transmission Company Limited.

In order that it be abundantly clear as to my position with regard to these two items, I set out below my reasons for arriving at the above conclusions, in order to determine "just and reasonable tolls" for Westcoast.

Deferred Income Taxes

In those decisions where the Board has allowed pipeline companies to calculate taxes on a normalized basis, it has required that the amount of accumulated deferred income taxes should be deducted from rate base to establish the amount to which the allowed rate of return is applied to calculate earnings. The Board has reached this view on the basis that such funds, which are considered to be invested in the pipeline assets, are obtained by the company at no cost, and therefore the company is not entitled to a return on that portion of its investment in the rate base that is financed by these funds.

Westcoast has suggested that, in calculating the amount of the deferred taxes to be deducted from the rate base, the utility should be deemed to have made the payments to the income tax authorities that would have been required if the jurisdictional operations of the utility were the only business enterprise of the Company. Because of the availability to

Westcoast of other tax deductions, it is not expected that it will actually pay any tax to the income tax authorities with respect to its operations for 1980 or 1981. This money would, therefore, be available in the hands of the Company to be invested in other assets from which it would expect earnings. If the suggestion of Westcoast were followed, the effect would be that the shareholders of Westcoast would be allowed a return on the assets financed by these deemed tax payments at the allowed rate of return. Westcoast would thus be able to earn a double return on the amount of the deemed payments to the income tax department, which in fact it does not make. Under these circumstances it is not legitimate that the deferred taxes to be deducted from the rate base be calculated in this manner. Rather, the deferred income tax that should be deducted from rate base should be the total of the normalized taxes allowed in the cost of service, less the amounts actually paid by the Company to the income tax authorities which would reasonably be considered to be in respect of earnings from its utility operations.

Calculating of Income Tax to be Allowed in Cost of Service

In its application Westcoast requested that, in fixing the return to be allowed on its rate base, a capital structure should be deemed for the Company, and an appropriate rate of return should be allowed on such deemed capital structure. On the basis of utilizing such a deemed capital structure it considered that the utility would therefore be considered on a "stand-alone basis". It then maintained that because its capital structure was considered on a "stand-alone" basis its income tax should also be calculated on a "stand-alone" basis.

I do not agree that the fact that a capital structure is deemed for a utility necessarily means that the utility is being considered on a "stand-alone" basis. Rather, I consider that deeming a capital structure, in the circumstances of the Westcoast case, effectively is an allocation of that part of

the Company's actual capital structure that is appropriate for its utility operations. On this basis it is not, therefore, a governing factor for income tax calculations.

The income tax that is to be allowed as part of the cost of service should be governed by conditions as they are. It is not correct to deem expenses on a fictional basis. All costs that are to be allowed should take into account the Company as it is, not the costs that might exist if conditions were, in fact, different.

The actual conditions under which the Company operates is that in filing its income tax return it claims all of its deductible expenses. Furthermore, it is the Company as a whole that files a tax return and pays taxes. A separate tax return cannot be filed for its utility operations, and separate taxes are not paid for only part of its operations.

Under these circumstances, the amount to be allowed in the cost of service should be a reasonable allocation of that part of its total actual expenses incurred by the Company which are applicable to its utility operations. No other expense included in cost of service exceeds the total of such expense actually paid by the Company. To the extent that the Company has taxable income from operations other than its utility, costs that apply to those other operations should be applied to reduce the non-utility taxable income. However, to the extent that such expenses exceed non-utility income subject to tax, they should be used to reduce utility taxes, since the allowed utility taxes should not exceed the total taxes applicable to the Company as a whole. In this way the non-utility operations of the Company would not be penalized, since they would have first claim on the expenses that were not included in the utility cost of service. However, to the extent that there were any of these expenses that have been allocated to the non-utility that were not required to reduce its non-utility taxable income to nil, they would be deducted

in calculating the amount of the income tax to be allowed in the utility cost of service.

The amount of income tax to be included in cost of service should therefore be determined by utilizing a tax rate obtained by calculating the normalized taxable income of the utility on the basis of utilizing the total tax deductible expenses allowable to the Company, to the extent those expenses allocated to its non-utility operations are not required to reduce its taxable income from its non-utility operations to nil.

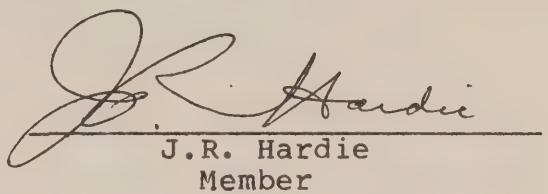
Allowance for Funds Capitalized

The Applicant requested that in calculating its normalized income tax it should include in taxable income the amount which it refers to as "Allowance for Funds Capitalized" (AFC). This represents an allowance for capitalized financing costs with respect to advances made to Foothills (Yukon). The Applicant's witnesses indicated that, while the details have not yet been established, it is the intention that Westcoast would receive capital stock of Foothills (Yukon) equal to the amount of the advances including the AFC. They also agreed that under the provisions of the Income Tax Act, amounts of AFC are not subject to tax, either when recorded on the books of Westcoast, or when the shares are received from Foothills.

Westcoast considered that these amounts should be included in the calculation of its income tax, since it would otherwise not fully recover the financing costs. These costs will not be allowed as a tax deduction in determining income taxes payable by Foothills and, thus, dividends available from Foothills will be less than they would be if these financing costs were tax deductible in Foothills' hands.

I do not consider this to be a legitimate reason to include the amount of AFC in Westcoast's normalized tax calculation. I do not see it as a role of the Board to change what the Company may consider to be a disadvantageous

provision of the Income Tax rules. Since, under the Income Tax Act, Westcoast will not be required to pay tax on this AFC, it should not be allowed to include it in the calculation of its normalized income tax.



J.R. Hardie
Member

ORDER NO. RH-4-80

IN THE MATTER OF the National Energy Board Act
and the Regulations made thereunder; and

IN THE MATTER OF applications by Westcoast
Transmission Company Limited (hereinafter called
"the Applicant") for certain orders respecting
rates and tolls pursuant to Part IV of the
National Energy Board Act, filed with the Board
under File Nos. 1562-W5-3 and 1562-W5-4

B E F O R E the Board on Thursday, the 5th day of June, 1980.

UPON an application dated the 31st day of March, 1980
being filed on behalf of the Applicant for an Order pursuant to
sections 50, 52 and 53 of the National Energy Board Act
effective the 1st day of April, 1980, disallowing the existing
tolls to be charged and received by Westcoast in accordance
with the schedule of tolls filed by Westcoast pursuant to Order
No. TG-5-79, and prescribing a new schedule of tolls
incorporating the changes specified in paragraph 10 of the said
application, and for special and general orders under section
53 of the Petroleum Administration Act setting the approved
price at which gas may be purchased by the Applicant to conform
with the said application;

AND UPON the Applicant having filed, as Volume II of
its Application, Prepared Testimonies, dated May 1980, and, as
Volume III of its Application, a Lead/Lag Study and Working
Papers, dated May 1980;

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AND UPON the Applicant having, pursuant to paragraph 14 of Schedule A to Order No. TG-5-79 filed a submission dated the 28th day of March, 1980, setting forth its operating and maintenance expense budget for the six-month period ending on the 31st day of December, 1980;

AND UPON the Board considering it advisable to hold a public hearing in respect of the said application and submission;

IT IS ORDERED THAT:

1. That part of the application dated the 31st day of March, 1980 made under Part IV of the National Energy Board Act, and the Submission dated the 28th day of March, 1980 (hereinafter referred to collectively as "the Applications"), will be heard at a public hearing commencing at 9:30 a.m. local time on the 6th day of August, 1980, in the Arbutus Room of the Four Seasons Hotel, 791 West Georgia Street, in the City of Vancouver, in the Province of British Columbia. Such proceedings will be conducted in either of the two official languages, and simultaneous interpretation will be provided should a party to the proceedings request such facilities in its intervention.

. . . /3

2. The Applicant shall, forthwith, serve a true copy of the Applications, including Volumes II and III dated May 1980, if not already served, and a true copy of this Order, upon all the Applicant's customers, the Attorneys General of the Provinces of British Columbia and Alberta, the British Columbia Energy Commission, the British Columbia Petroleum Corporation, the Canadian Gas Association, the Canadian Petroleum Association, Esso Resources Canada Limited, and the Independent Petroleum Association of Canada, and, as soon as possible upon such other persons who have intervened pursuant to paragraph 4 hereof.

3. Notice of the said hearing in the form prescribed by the Board as set forth in Appendix I attached to and forming part of this Order shall be published on or before the 19th day of June, 1980, in one issue of each of "The Vancouver Sun" and "The Vancouver Province" in the City of Vancouver, "The Colonist" in the City of Victoria, "The Kamloops Sentinel" in the City of Kamloops, all in the Province of British Columbia; "The Herald" in the City of Calgary and "The Journal" in the City of Edmonton, both in the Province of Alberta; "The Globe and Mail" and "The Financial Post" in the City of Toronto, "The Citizen" and "Le Droit" in the City of Ottawa, all in the Province of Ontario; the "Financial Times of Canada" in the City of Montreal, in the Province of Quebec; and, as soon as may be possible, in the Canada Gazette.

. . . /4

4. Any person intending to oppose or intervene in the said Applications shall, on or before the 9th day of July, 1980, file with the Secretary of the Board thirty (30) copies of a written statement containing its reply or submission, together with any supporting information, particulars or documents, which shall include a concise statement of the facts from which the nature of the respondent's or intervenor's interest in the proceedings may be determined, which may admit or deny any or all of the facts alleged in the Applications, which shall be endorsed with the name and address of the respondent or intervenor or his solicitor to whom communications may be sent and which shall state the official language in which the respondent or intervenor wishes to be heard. Any respondent or intervenor shall, on or before the 9th day of July, 1980, serve three (3) copies of his reply or submission and supporting information, particulars or documents upon the Applicant and one (1) copy each upon the Attorneys General of the Provinces of British Columbia and Alberta, the British Columbia Energy Commission, British Columbia Hydro and Power Authority, the British Columbia Petroleum Corporation, the Canadian Gas Association, the Canadian Petroleum Association, Esso Resources Canada Limited, the Independent Petroleum Association of Canada, and Inland Natural Gas Co. Ltd.

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5. The Applicant shall prepare its direct evidence written in question and answer form with lines numbered (hereinafter called "written direct evidence") for each of its witnesses and shall,

- (a) on or before the 9th day of July, 1980, file thirty (30) copies thereof with the Board and serve one copy of the same upon each person specified in Paragraph 2 of this Order, and
- (b) as soon as possible, serve one copy of the same upon any other party who has intervened pursuant to paragraph 4 of this Order.

6. Any party who has intervened pursuant to paragraph 4 hereof and who wishes to present direct evidence in the Hearing, shall prepare written direct evidence, and shall, on or before the 28th of July, 1980, file thirty (30) copies thereof with the Board and serve one (1) copy of the same upon the Applicant and each other party who has intervened pursuant to paragraph 4 hereof, a list of which intervenors will be available from the Board on the 14th day of July, 1980.

7. The Rules and Procedures set out in Appendix II to this Order shall govern the conduct of the Hearing.

8. Any interested party may examine a copy of the Application and the submissions filed therewith at the office of:

. . . /6

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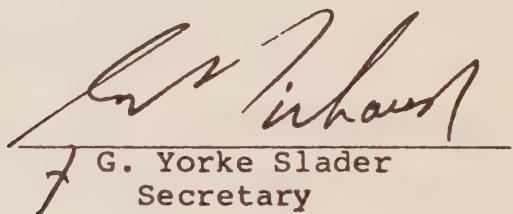
National Energy Board
Trebla Building
473 Albert Street
Ottawa, Ontario.
K1A 0E5

or at the offices of the Applicant at the following address:

Westcoast Transmission Company Limited
1333 West Georgia Street
Vancouver, British Columbia.
V6E 3K9

DATED at the City of Ottawa, in the Province of
Ontario, this 5th day of June, 1980.

NATIONAL ENERGY BOARD



G. Yorke Slader
G. Yorke Slader
Secretary

RH-4-80

APPENDIX I
TO ORDER NO. RH-4-80

NATIONAL ENERGY BOARD

NOTICE OF HEARING

TAKE NOTICE THAT Westcoast Transmission Company Limited, hereinafter called "the Applicant" has filed an application dated the 31st day of March, 1980, first for an order pursuant to sections 50, 52, and 53 of the National Energy Board Act, effective the 1st day of April, 1980, disallowing the existing tolls to be charged and received by Westcoast in accordance with the schedule of tolls filed by Westcoast pursuant to Order No. TG-5-79, and prescribing a new schedule of tolls incorporating the changes specified in paragraph 10 of the said application, and for special and general orders under section 53 of the Petroleum Administration Act setting the approved price at which gas may be purchased by the Applicant to conform with the said application, and, second, for special and general orders under section 53 of the Petroleum Administration Act setting the approved price at which gas may be purchased by the Applicant to conform with the said application;

AND TAKE NOTICE THAT the Applicant has, pursuant to paragraph 14 of Schedule A to Order No. TG-5-79, filed a submission dated the 28th day of March, 1980, setting forth its operating and maintenance expense budget for the six-month period ending on the 31st day of December, 1980.

- 2 -

THE BOARD HAS ORDERED

1. That that part of the application dated 31 March 1980 made under Part IV of the National Energy Board Act, and the Submission dated 28 March 1980 (hereinafter referred to collectively as the "Applications"), will be heard at a public hearing commencing at 9:30 a.m. local time on 6 August 1980 in the Arbutus Room of the Four Seasons Hotel, 791 West Georgia Street, in Vancouver, British Columbia. Such proceedings will be conducted in either of the two official languages and simultaneous interpretation will be provided should a party to the proceedings request such facilities in its intervention.
2. Any person intending to oppose or intervene in the said Applications shall, on or before 9 July 1980, file with the Secretary of the Board thirty (30) copies of a written statement containing his reply or submission, together with any supporting information, particulars or documents, which shall include a concise statement of the facts from which the nature of the respondent's or intervenor's interest in the proceedings may be determined, which may admit or deny any or all of the facts alleged in the Applications, which shall be endorsed with the name and address of the respondent or intervenor or his solicitor to whom communications may be sent, and which shall state the official language in which the respondent or intervenor wishes to be heard.

- 3 -

Any respondent or intervenor shall, on or before 9 July 1980, serve three (3) copies of his reply or submission and supporting information, particulars or documents upon the Applicant and one (1) copy each upon the Attorneys General of the Provinces of British Columbia and Alberta, the British Columbia Energy Commission, British Columbia Hydro and Power Authority, the British Columbia Petroleum Corporation, the Canadian Gas Association, the Canadian Petroleum Association, Esso Resources Canada Limited, the Independent Petroleum Association and Inland Natural Gas Co. Ltd.

3. Any party who has intervened pursuant to paragraph 2 hereof and who wishes to present direct evidence, shall prepare written direct evidence, and shall, on or before 28 July 1980, file thirty (30) copies thereof with the Board and serve one (1) copy of the same upon the Applicant and each of the parties who have intervened pursuant to paragraph 2 hereof.

4. Any interested party may examine a copy of the Applications and the submissions filed therewith at the office of:

National Energy Board
Trebla Building
473 Albert Street
OTTAWA, Ontario
K1A 0E5

or at the offices of the Applicant at the following address:

Westcoast Transmission Company Limited
1333 West Georgia Street
VANCOUVER, British Columbia
V6E 3K9.

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DATED at the City of Ottawa, in the Province of
Ontario, this 5th day of June, 1980

NATIONAL ENERGY BOARD

G. Yorke Slader,
Secretary.

APPENDIX II TO
ORDER NO. RH-4-80

RULES AND PROCEDURES

1. In these Rules, "party" means Westcoast Transmission Company Limited and any respondent or intervenor who has filed with the Secretary of the Board a written statement pursuant to paragraph 4 of Order No. RH-4-80.
2. At the public hearing of the Application by Westcoast Transmission Company Limited, the evidence shall be heard in the following order:
 - (1) Application dated 31 March 1980,
 - (2) Submission dated 28 March 1980 respecting the operating and maintenance expense budget for the six months ending 31 December 1980.
3. The Board shall hear the evidence of all parties in respect of the Application of 31 March 1980, and then the evidence of all parties in respect of the submission of 28 March 1980.
4. Upon completion of all the evidence referred to in paragraph 2 of the Rules, the Board shall hear the oral argument of all parties.
5. Any party who wishes to obtain additional information from the Applicant in respect of matters raised in the Application and the Submission may request in writing that such information be provided and the Applicant shall, as soon as possible, make a written response to that request. Wherever possible, in order to expedite the Hearing, these requests and responses should be made before the commencement of the Hearing.

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6. Where a party files and serves written direct evidence pursuant to paragraph 6 of Order No. RH-4-80, any other party may request in writing that the party filing such written direct evidence provide additional information respecting the matters dealt with in the direct evidence and the party to whom such a written request is made shall, as soon as possible, make a written response to that request.

7. Both the written request and the response thereto, referred to in paragraphs 5 and 6 of these Rules, shall be filed as exhibits at the hearing.

8. If any question arises upon which a decision of the Board may be required, a notice of motion with respect thereto shall be filed with the Secretary of the Board, and the motion shall be heard by the Board at the Hearing on a date to be fixed by it.

9. The order of appearances of parties and sequence of adducing evidence and conducting cross-examination shall be announced by the Board on or before the opening of the hearing.

APPENDIX B

INCOME TAXES

The implementation of the Board's decisions with respect to income taxes must be integrated with the decisions taken in respect of capital structure. Accordingly, the Board has computed the effective normalized tax rate of 6.14 percent in the steps set forth in the following pages:

CALCULATION OF AVERAGE DEFERRED INCOME TAXES (\$000)

For purposes of computing rate base, average deferred income taxes have been calculated as follows:

$$\begin{aligned}
 & \frac{2 \times \text{Beginning deferred tax balance} + \text{Net timing differences} \times \text{Tax Rate}}{2} \\
 = & \text{Beginning deferred tax balance} + \frac{\text{Net timing differences} \times \text{Tax Rate}}{2} \\
 = & 3,367^{(a)} + \frac{41,239^{(b)} \times .50934^{(c)}}{2} \\
 = & 3,367 + \frac{21,004}{2} \\
 = & 3,367 + 10,502 \\
 = & \underline{13,869}
 \end{aligned}$$

NET TIMING DIFFERENCES (For the Test Year)

Depreciation	40,549
Amortization	2,116
Amortization of Debt Expense	203
Prepaid Insurance	491
Capital Cost Allowance	(80,479)
Overhead During construction	(1,800)
Interest AFUDC	(0)
Cumulative Eligible Capital-Land Rights	(35)
Cumulative Eligible Capital-Debt	(90)
Prepaid Insurance	(484)
Financing Expenses	(1,710)
	<u>(41,239)</u>

(a) Per Exhibit 81, page 1 of 7.

(b) Per Exhibit 81, page 5 of 7. NOTE: Interest AFUDC has been eliminated so as to be consistent with the format used to compute normalized taxes.

(c) Per Exhibit 15, Tab 8.

CALCULATION OF RATE BASE AND TOTAL CAPITALIZATION (\$000)

Net Plant In Service(a)	719,539
Gas Plant Held For Future Use(a)	4,427
Preliminary Surveys and Investigations(a)	189
Contributions In Aid of Construction(a)	(1,280)
Working Capital(a)	<u>18,376</u>
Average Rate Base Before Cash Working Capital and Deferred Taxes	741,251
Average Cash Working Capital(a)	4,148
Average Deferred Taxes(b)	(13,869)
Average Rate Base	<u>731,530</u>
Average Construction Work In Progress(c)	<u>23,752</u>
Total Average Capitalization	<u>755,282</u>

(a) Source: Exhibit 11, Rate Base, Tab 1, Page 1 - 13-Month Average.

(b) See Page 2 of this Appendix.

(c) Source: Exhibit 11, Rate Base, Tab 2, Page 2 of 2 - 13-Month Average.

CALCULATION OF EFFECTIVE NORMALIZED TAX RATE (\$000)

Income After Tax (a)	41,331
Net Permanent Differences (b)	<u>1,925</u>
Normalized Taxable Income	<u>43,256</u>
Normalized Taxes at 50.934% (c)	<u>44,903</u>
Normalized Tax Factor = $\frac{\text{Normalized Taxes}}{\text{Income After Tax}}$	= 1.086424
Effective Normalized Tax Rate = 1.086424 (5.65%) (d)	
	= <u>6.14%</u>

(a) Sum of allowed weighted average costs of preferred and common equity multiplied by rate base i.e., (.40% + 5.25%) x (731,530).

(b) Basic amounts per Exhibit 81, page 3 of 7 with due alteration to reflect revised format for computing normalized taxes.

Amortization of Debt Expense	304
Foreign Exchange Loss-Principal	1,329
Amortization AFUDC Equity	300
Excess Pension and Savings Plan	194
Equity AFUDC-Current	(0)
Gain on Purchase of Debt	(0)
Inventory Allowance	(202)
	<u>1,925</u>

(c) Tax rate per Exhibit 15, Tab 8.

(d) Sum of the allowed weighted average costs of preferred and common equity.

NATIONAL ENERGY BOARD



OFFICE NATIONAL DE L'ÉNERGIE

ORDER NO. AO-4-TG-5-79

IN THE MATTER OF the National Energy Board Act and the Regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Transmission Company Limited (hereinafter called "Westcoast") for certain orders respecting rates and tolls pursuant to Part IV of the National Energy Board Act, filed with the Board under File Nos. 1562-W5-3 and 1562-W5-4.

BEFORE:

L.M. Thur,)	
Associate Vice-Chairman)	
	)	on Thursday, the 13th
J.R. Hardie,)	
Member	)	day of November, 1980.
)	
R.B. Horner,)	
Member)	

UPON an application by Westcoast Transmission Company Limited dated the 31st day of March, 1980, for an order pursuant to sections 50, 52, and 53 of the National Energy Board Act, effective the 1st day of April, 1980, disallowing the existing tolls to be charged and received by Westcoast in accordance with the schedule of tolls filed by Westcoast pursuant to Order No. TG-5-79, and prescribing a new schedule of tolls incorporating the changes in the manner of calculating Westcoast's tolls specified in paragraph 10 of the said application, as amended, and for special and general orders under section 53 of the Petroleum Administration

- 2 -

Act setting the approved price to conform with the said application;

AND UPON the Board having, by Order No. RH-4-80 dated the 5th day of June, 1980, set down that part of the said application made under Part IV of the National Energy Board Act for a public hearing commencing on the 6th day of August, 1980;

AND UPON the Board having held the hearing of the said application in the City of Vancouver, in the Province of British Columbia, from the 6th day of August, 1980, to the 20th day of August, 1980, and in the City of Ottawa, in the Province of Ontario, from the 3rd day of September, 1980, to the 12th day of September, 1980;

AND UPON the Board being satisfied that the tolls to be charged and received by Westcoast, effective the 1st day of January, 1981, in accordance with Order No. TG-5-79, as amended by this Order, and the Board's Reasons for Decision dated November, 1980, in the Matter of an Application under Part IV of the National Energy Board Act of Westcoast Transmission Company Limited (hereinafter the "November 1980 Reasons for Decision") are just and reasonable;

AND UPON the Board considering it necessary by reason of having issued Order No. AO-2-TG-5-79 to make a consequential amendment to paragraph 8 of Order No. TG-5-79;

1. IT IS ORDERED THAT Order No. TG-5-79, as amended, be and the same is hereby changed, altered and varied, effective the 1st day of January, 1981, by

(a) revoking paragraphs 1(c)(iii) and (iv) of Schedule B to the said Order and substituting therefor the following:

"(iii) Gas Plant in Service

Gas Plant in Service shall be adjusted to include capital expenditures on construction approved by the Board under Part III of the N.E.B. Act and for which leave to open, if required, has been granted, but shall exclude any amount relating to such plant which has been the subject of an extraordinary retirement.

(iv) Accumulated Depreciation

Accumulated depreciation shall be adjusted for depreciation expense included in the cost of service, but shall exclude any amount relating to Gas Plant in Service which has been the subject of an extraordinary retirement."

(b) revoking paragraph 1(c)(viii) of Schedule B to the said Order and substituting therefor the following:

"(viii) Cash Working Capital

Cash Working Capital each month shall be equal to 130 percent of the Operating and Maintenance Expenses (excluding charges for transportation by others) included in the cost of service for that month."

(c) revoking paragraph 1(c)(xii) of Schedule B to the said Order and substituting therefor the following:

"(xii) Deferred Income Taxes

The amount to be deducted from rate base in any month for Deferred Income Taxes shall be the accumulated deferred income taxes for the previous month.

Effective the month of January, 1981, the accumulated deferred income taxes shall be calculated on the basis of an allocation of items of income and expense between Westcoast's utility and nonutility operations, as authorized in the November 1980 Reasons for Decision."

(d) revoking paragraph 2(b)(v) of Schedule B to the said Order and substituting therefor the following:

"(v) Taxes Other Than Income Taxes

Taxes Other Than Income Taxes shall be the actual amounts paid in the absence of unusual circumstances.

Such taxes shall include any Excise Tax actually paid in any month in respect of natural gas consumed in pipeline operations by Westcoast.

Corporation Capital Taxes attributable to utility operations shall be determined in accordance with the November 1980 Reasons for Decision.

Corporation Capital Taxes and Business and Property Taxes included in the cost of service for each month shall be based on 1/12 of the taxes estimated to be payable for the year, but the annual total of the monthly amounts for each tax shall not exceed the actual taxes for the period to which they apply."

(e) revoking paragraph 2(b)(viii) of Schedule B to the said Order and substituting therefor the following:

"(viii) Return on Rate Base and Income Taxes

The Return on Rate Base shall be the amount calculated by multiplying 1/12 of the allowed Rate of Return (exclusive of income taxes) of 11.51 percent by the average monthly Rate Base for toll purposes.

The provision for income taxes shall be the amount calculated by multiplying 1/12 of the approved effective income tax rate of 6.14 percent by the average monthly Rate Base for toll purposes."

2. AND IT IS FURTHER ORDERED THAT Order No. TG-5-79, as amended, be and the same is hereby changed, altered and varied, effective the 13th day of November, 1980, by revoking paragraph 9 thereof and substituting therefor the following:

"9. Where Westcoast incurs expenses in respect of the items referred to in paragraphs 8 and 8.1 in excess of the amounts specified in Schedules E and F to this Order, Westcoast shall include those excess expenses in Account 179 - Other Deferred Debits - together with carrying

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charges on the month-end balance of the account at 1/12 of the sum of the prime interest rate plus 1 percent."

3. AND IT IS FURTHER ORDERED THAT Westcoast shall, on or before the 2nd day of February, 1981, file with the Board and serve upon interested parties that information respecting its retired turbine units and the Pine River Gas Processing Plant specified in the November 1980 Reasons for Decision.

NATIONAL ENERGY BOARD

G. Yorke Slader

G. Yorke Slader
Secretary

